the section extends to this latter form of trust.

3. *"Sufficient" Indication of Charitable Intention.* In dealing with what is a "sufficient" indication of charitable intention the Privy Council thought that this might arise from a "predominantly charitable" or from a "significant" indication of charitable intent. In the High Court, Dixon, C.J., and McTiernan, J. referred to a "distributable" class which is "predominantly" charitable in character; to a "distinct" indication of a charitable intention, to what is *"prima facie"* charitable. These explanations take us little beyond the holding that s.37D will extend to a composite expression provided there is an indication which the Court finds "clear" that a charitable intention on the part of the donor is embraced within it.

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REDUCTION OF SHARE CAPITAL

AUSTRALASIAN OIL EXPLORATION v. *LACHBERG*

For a company to distribute to its shareholders, in cash or in kind, any of its subscribed capital, is to offend against ". . . the fundamental principle of company law that the whole of the subscribed capital of a company with limited liability, unless diminished by expenditure upon the company's objects or . . . by means sanctioned by statute shall remain available for the discharge of its liabilities."[1] While the recent much discussed High Court decision in the *A.O.E. Case*[2] turns on a particularly complicated agreement between two companies, it does provide a clear application of the above principle,[3] with some interesting reflections on distribution of casual profit made on the sale of single assets otherwise than in the course of ordinary business activities.

By an agreement dated February 17, 1958, Australasian Oil Exploration Ltd. (here called A.O.E.) sold to Mary Kathleen Investments Ltd. (here called "M.K.I.") 994,900 shares held by the vendor company in another company, Mary Kathleen Uranium Ltd. (here called "M.K.U.") a holding which carried the right to appoint two directors. The purchase price was £346,720 and the Investments Company undertook within 60 days to offer to the Exploration Company shareholders fifteen Investment Company shares at 5/- each, for every 100 Exploration Company shares held, and to offer to exchange ten Investment Company shares for every 100 Exploration Company shares held. There was a provision directed at preserving the Exploration Company's right to appoint directors of the Uranium Company. The 994,900 shares formed the Exploration Company's principle asset and were valued in the last balance sheet at £248,725, although they were in some of the Company's documents declared to be of a value of £2,000,000. When the agreement was made the company's paid up capital amounted to £2,782,348. However, according to a balance sheet published on 30th April, 1957, it had sustained a loss to its share capital amounting to £1,716,513 leaving total shareholders' funds at £1,065,835. The assets consisted of the M.K.U. shares valued in the balance sheet at £248,725, and fixed assets and other items representing pre-paid expenses, loans and stores in hand, which were all valued extremely highly. Evidence was given, and accepted by the lower court, that the M.K.U. shares were worth greatly in excess of the balance sheet figure of £248,725, and also in excess of the sale price figure of £346,720. This appeal was brought by A.O.E. against the respondent shareholder in *A.O.E.* (*Lachberg*) from the decision of Wolff, J., in the

[1] *Davis Investments Pty. Ltd.* v. *Commissioner of Stamp Duties* (1958) A.L.R. 561 at 568, *per* Kitto, J.

[2] (1959) Argus L.R. 65 (H.C.).

[3] See *supra* n. 1.

Supreme Court of Western Australia, who had held the whole agreement to be *ultra vires* and void, and further had ordered that A.O.E. be restrained from registering any transfers of A.O.E. shares pursuant to the agreement.

In the High Court's view the whole purpose of the agreement was to get A.O.E. out of serious financial difficulty and to provide capital to enable the new company, M.K.I., to carry on the work of A.O.E. and to protect the M.K.U. shares from creditors of A.O.E. The High Court briefly summarised the result of all these dealings, if and when accepted by the A.O.E. shareholders at a shareholders' meeting and carried into effect, as follows:

1. M.K.I. would have become the beneficial owners of the 994,900 shares in M.K.U. and this holding would have constituted M.K.I.'s only assets;
2. A.O.E. shareholders would have become the holders of the vast majority of the shares in M.K.I.;
3. M.K.I. would have used £346,720 of the moneys subscribed for its new shares to discharge its obligations under Clause 2 of the agreement of 17th February, 1958;[4]
4. M.K.I. would have become the sole shareholder in A.O.E.; and
5. The liabilities of A.O.E. would have been discharged out of the sum of £346,720 paid to its bankers by M.K.I.

The court pointed out that if the sale of the shares was made simply to discharge an indebtedness then it could not be attacked, even though it were made at an undervalue, provided the company had power in its Articles of Association to do so.[5] However, an examination of the nature and character of this transaction showed that the M.K.U. shares were sold greatly below their true value and that the other assets of the A.O.E. were considerably above their true value, so that the main asset of A.O.E. was the 994,900 shares in M.K.U. Furthermore, the stipulation in the agreement for the exchange of shares and the issuing of new shares for cash was an essential part of the agreement, was framed in the language of contract and imposed an obligation on M.K.I. as a condition of the agreement to issue its shares in accordance with its terms.

Section 158(1)(c) of the Companies Act, 1936[6] provides:

> Subject to confirmation by the Court, a company limited by shares or a company limited by guarantee and having a share capital may, if so authorised by its articles, by special resolution reduce its share capital in any way, and in particular, without prejudice to the generality of the provisions of this section, may . . . either with or without extinguishing or reducing liability on any of its shares, pay off any paid-up share capital which is in excess of the wants of the company, . . . and may, if and so far as is necessary, alter its memorandum by reducing the amount of its share capital and its shares accordingly.

Apart from the statutory rule in s.158(1)(c), the common law principle has long been established that dividends cannot be paid out of capital even though the Articles of Association purport to give the company power to do so,[7] for this would amount to a reduction of capital, and a reduction of capital can be effected only in the manner prescribed by law.[8]

It is clear that A.O.E. could not have distributed the M.K.I. shares to its

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[4] Cl. 2 of the Agreement provided that the purchase price was fixed at £346,720 and it was agreed that this sum should be paid within ninety days from the date of the agreement. Further it was provided that A.O.E. should deliver to M.K.I. upon the execution of the agreement a document of transfer in registrable form signed in blank by A.O.E. as transferor and, also, an irrevocable authority to obtain delivery of the relevant share certificates from A.O.E.'s bankers on payment of the purchase money.

[5] See *Thomson* v. *Trustees Corporation* (1895) Ch. 454.

[6] No. 33 of 1936.

[7] *Verner* v. *General and Commercial Investment Trust* (1894) 2 Ch. 239. Another example is *Re Sharpe* (1892) 1 Ch. 154.

[8] *Grimmes* v. *Land Corporation of Ireland* (1883) 22 Ch. D. 349. And see also *Trevor* v. *Whitworth* (1887) 12 A.C. 409.

own shareholders as this would have been the same as selling the shares outright and distributing the money so obtained to its shareholders as dividends—a position which clearly offends s.158(1)(c) and is *ultra vires* and void.[9] The actual scheme adopted sought to achieve the same result through the creation of a new company, M.K.I.[10] The court held that since the allotment of shares to A.O.E. shareholders by the direction of A.O.E. was an essential part of the agreement then this was just as much a distribution of capital as selling the shares and distributing the moneys obtained.

In determining whether profits are available for distributing a dividend it is necessary to see that the capital is intact. As Lindley, L.J. has said,

> Although there is nothing in the statutes requiring even a limited company to keep up its capital and there is no prohibition against payment of dividends out of any other of the company's assets, it does not follow that dividends may be lawfully paid out of other assets regardless of the debts and liabilities of the company.[11]

In the A.O.E. case if it were sought to uphold the agreement as *intra vires* on the ground that the provision for exchange of shares and the right to subscribe for new shares was in the nature of a "dividend", the argument must necessarily fail as the arrangement clearly infringes this principle. The position would have been different if the M.K.U. shares were correctly valued in the books of A.O.E. and the Company had not lost any of its capital. The word "capital" as used in this context was defined by Lindley, L.J., in *Verner's Case* as ". . . money subscribed pursuant to the Memorandum of Association, and what is represented by that money".[12] Any accretion to that capital, e.g. here the M.K.U. shares, could have been realized and turned into cash and distributed to the shareholders without infringing any principle of company law. If, for instance, M.K.U. shareholders became entitled to a bonus issue of shares, the directors of A.O.E. could, if the capital of the company was intact and the M.K.U. shares correctly valued, distribute such bonus issue to its shareholders without the sanction of the court.[13] The important point is that the capital of the company must be kept "intact" before such a distribution can be made. In the A.O.E. case the capital of the company was far from remaining "intact", as the M.K.U. shares were the only real asset of any value held by the company.

It was argued on behalf of A.O.E. that, if a company engages in a transaction whereby it disposes, otherwise than in the course of its trading or business activities, of a single capital asset for a price in excess of the value at which that asset stands in its books, it may lawfully distribute the casual profit so made among its shareholders whatever the capital position of the company might otherwise be. This argument was rejected on the grounds of the decision in *Lubbock* v. *British Bank of South Africa*[14] and the cases which have followed it.[15] The principle is that the capital fund must be intact before a capital surplus is distributed, and, for this purpose, a *bona fide* valuation of the assets and liabilities of the whole undertaking must be made.[16] Any capital loss must be made good before such a distribution is made and, of course, the distribution must be authorised by the Articles of Association. The question

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[9] See *Ex p. Westburn Sugar Refineries Ltd.* (1951) A.C. 625.

[10] It is clear from the actual scheme adopted that this was not the prime consideration of the directors of A.O.E. in instituting the scheme but nevertheless was a necessary result of the scheme.

[11] *Verner* v. *General and Commercial Investment Trust* (1894) 2 Ch. 239, 265.

[12] (1894) 2 Ch. 239 at 263.

[13] *Moore* v. *Carerras* (1935) V.L.R. 68. And see also *Ex p. Westburn Sugar Refineries Ltd.* (1951) A.C. 625.

[14] (1892) 2 Ch. 198 at 201.

[15] *Verner* v. *General and Commercial Investment Trust* (1894) 2 Ch. 239, 265; *Foster* v. *New Trinidad Lake Asphalt Co. Ltd.* (1901) 1 Ch. 208, 212; and *Cross* v. *Imperial Continental Gas Association* (1923) 2 Ch. 553, 565.

[16] *Foster* v. *New Trinidad Lake Asphalt Co.* (1901) 1 Ch. 208.

whether a company has profits available for distribution must be answered according to the circumstances of each particular case, the nature of the company and the evidence of competent witnesses,[17] and in considering whether there has been a loss of capital it is immaterial whether that loss is an actual, ascertained and realised loss of capital, or a loss by estimated and valued depreciation.[18]

The clearest illustration of the principle of distribution of casual profit is *Cross* v. *Imperial Continental Gas Association*[19] where it was held that compensation payable to the defendant association for the compulsory acquisition of its gas undertakings in various German towns, resulting in the realization by the Association of a very considerable profit upon the book value of these undertakings, could be distributed as realisable profit in its capital assets by way of dividend.

Although the basic principle that dividends cannot be paid out of capital seems simple, its application may raise questions of the utmost difficulty. Every transaction which may infringe the principle must be judged on its special facts. Halsbury, L.C., said in *Dovey* v. *Corey* that courts move cautiously among concrete cases because "many matters will have to be considered by men of business which are not altogether familiar to a court of law".[20] And he quoted Lindley, L.J.'s observation that Parliament had left to men of business "what is to be put into a capital account, what into an income account".[21] These are questions for the shareholder and directors to decide subject to any restrictions or directions contained in the articles or by-laws of the company. In the *A.O.E. Case* the court examined the true effect of the agreement in dispute and found it *ultra vires*, despite its finding that the intended effect of the agreement was quite a businesslike and honourable one.

There have been many conflicting views as to what constitutes capital, and as to the correct distinction between "fixed" and "circulating" capital for the purposes of determining whether a dividend has been declared so as not to offend s.158 of the Companies Act.[22] The A.O.E. case has illustrated that, while the court will give due regard to the opinions of men of business as to the correct method of keeping accounts and as to what shall constitute profit for distribution, it will always be ready to attack a distribution if, in the court's opinion, the moneys distributed cannot fairly be classed as distributable profit.

Modern accountancy and company administration are so complicated that any attempt by the courts to define in a narrow way the terms "profit", "capital" and "dividend" for the purpose of this rule could easily cause widespread confusion. The interests of creditors and debenture holders of a limited company are to a substantial degree protected, it is submitted, by the power of the court to go behind company balance sheets and statements, despite the evidence of company officers as to how the company has treated the moneys or assets in dispute. The court will always give due consideration to the views of business men but will not necessarily accept them as final and conclusive.

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THE ACTION *PER QUOD SERVITIUM AMISIT* *COMMISSIONER FOR RAILWAYS (N.S.W.)* v. *SCOTT*

In the development of the tort of negligence our law seems to have set

[17] *Bond* v. *Barrow Haematite Steel Co.* (1902) 1 Ch. 253.
[18] *Dovey* v. *Corey* (1901) A.C. 471.
[19] (1923) 2 Ch. 553. See also Byrne, J., in *Foster* v. *New Trinidad Lake Asphalt Co.* (1901) 1 Ch. 208.
[20] (1901) A.C. 477 at 486-87.
[21] *Lee* v. *Neuchatel Lake Asphalt Co.* (1889) 41 Ch. D. 1, 21.
[22] (1936), No. 33 of 1936.